

**SOUTH CAROLINA SCHOOL
FOR THE DEAF AND THE BLIND
SPARTANBURG, SOUTH CAROLINA**

STATE AUDITOR'S REPORT

JUNE 30, 1998

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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

May 11, 1999

The Honorable James H. Hodges, Governor
and
Members of the Board of Commissioners
South Carolina School for the Deaf and the Blind
Spartanburg, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the South Carolina School for the Deaf and the Blind, solely to assist you in evaluating the performance of the School for the fiscal year ended June 30, 1998, in the areas addressed. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures and the associated findings are as follows:

1. We tested selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the tested receipt transactions were adequate. We also tested selected recorded receipts to determine if these receipts were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement. We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law. We also compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year to determine the reasonableness of amounts collected and recorded by revenue account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Management Control over Financial Operations in the Accountant's Comments section of this report.

2. We tested selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the School, and were paid in conformity with State laws and regulations and if internal controls over the tested disbursement transactions were adequate. We also tested selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to various STARS reports to determine if recorded expenditures were in agreement. We compared current year expenditures to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account. The individual transactions selected for testing were chosen randomly. Our finding as a result of these procedures is presented in Management Control over Financial Operations in the Accountant's Comments section of this report.
3. We tested selected recorded payroll disbursements to determine if the tested payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the tested payroll transactions were adequate. We tested selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS. We also tested payroll transactions for selected new employees and those who terminated employment to determine if internal controls over these transactions were adequate. We compared amounts recorded in the general ledger and subsidiary ledgers to various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement. We performed other procedures such as comparing current year payroll expenditures to those of the prior year; comparing the percentage change in personal service expenditures to the percentage change in employer contributions; and computing the percentage distribution of fringe benefit expenditures by fund source and comparing the computed distribution to the actual distribution of recorded payroll expenditures by fund source to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account. The individual transactions selected for testing were chosen randomly. Our finding as a result of these procedures is presented in Payroll in the Accountant's Comments section of this report.
4. We tested selected recorded journal entries and all operating and appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate. The journal entries selected for testing were chosen randomly. Our finding as a result of these procedures is presented in General Ledger in the Accountant's Comments section of this report.

5. We tested selected entries and monthly totals in the subsidiary records of the School to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and the internal controls over the tested transactions were adequate. The transactions selected for testing were chosen randomly. Our finding as a result of these procedures is presented in General Ledger in the Accountant's Comments section of this report.
6. We obtained all monthly reconciliations prepared by the School for the year ended June 30, 1998, and tested selected reconciliations of balances in the School's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. For the selected reconciliations, we recalculated the amounts, agreed the applicable amounts to the School's general ledger, agreed the applicable amounts to the STARS reports, determined if reconciling differences were adequately explained and properly resolved, and determined if necessary adjusting entries were made in the School's accounting records and/or in STARS. The reconciliations selected for testing were chosen randomly. Our finding as a result of these procedures is presented in Reconciliations in the Accountant's Comments section of this report.
7. We tested the School's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 1998. Our findings as a result of these procedures are presented in our findings described in procedures 1, 2, 3, 6, and 9.
8. We reviewed the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the School resulting from our engagement for the fiscal year ended June 30, 1997, to determine if adequate corrective action has been taken. Our findings as a result of these procedures are presented in Payroll, Operating Lease Closing Package, and Reconciliations in the Accountant's Comments section of this report.
9. We obtained copies of all closing packages as of and for the year ended June 30, 1998, prepared by the School and submitted to the State Comptroller General. We reviewed them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our finding as a result of these procedures is presented in Operating Lease Closing Package in the Accountant's Comments section of this report.
10. We obtained a copy of the schedule of federal financial assistance for the year ended June 30, 1998, prepared by the School and submitted to the State Auditor. We reviewed it to determine if it was prepared in accordance with the State Auditor's letter of instructions; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. We found no exceptions as a result of the procedures.

The Honorable James H. Hodges, Governor
and
Members of the Board of Commissioners
South Carolina School for the Deaf and the Blind
May 11, 1999

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified areas, accounts, or items. Further, we were not engaged to express an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express such opinions. Had we performed additional procedures or had we conducted an audit or review of the School's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor and of the governing body and management of the School for the Deaf and the Blind and is not intended to be and should not be used by anyone other than these specified parties.

Thomas L. Wagner, Jr., CPA
State Auditor

ACCOUNTANT'S COMMENTS

SECTION A - MATERIAL WEAKNESSES AND/OR VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

The procedures agreed to by the agency require that we plan and perform the engagement to obtain reasonable assurance about whether noncompliance with the requirements of State Laws, Rules, or Regulations occurred and whether internal accounting controls over certain transactions were adequate. Management of the entity is responsible for establishing and maintaining internal controls. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Therefore, the presence of a material weakness or violation will preclude management from asserting that the entity has effective internal controls.

The conditions described in this section have been identified as material weaknesses or violations of State Laws, Rules, or Regulations.

PAYROLL

When testing payroll transactions, we found that the School made numerous payroll calculation errors. The errors resulted in both overpayments and underpayments to employees. All of the errors were immaterial amounts. Each was related to calculations of pay for payroll periods and termination pay. [Similar findings were included in the State Auditor's Reports on the School for fiscal years 1992, 1993, 1994, 1995, and 1997. We applied no procedures to the School's accounting records and internal controls for the year ended June 30, 1996.]

The accounting department follows no consistent method to calculate amounts for partial payroll periods and for termination pay. Some of the methods used are percentages of days worked in the pay period, hours worked in the pay period, days not worked in the pay period, and hours not worked in the pay period. Other errors occur because the calculations of annual leave payments, semi-monthly pay amounts and dates of termination are not subject to independent verification.

For twelve-month employees, the Comptroller General's preferred method for calculating pay for partial payroll periods uses the ratio of actual days worked to total work days in the pay period. For less than twelve-month employees, the School's method, as approved by the Comptroller General, is to multiply the daily rate by the days worked in the period where the daily rate is calculated as the employee's annual salary equivalent divided by the number of work days for the year. Section 8-11-30 of the 1976 South Carolina Code of Laws states, "It is unlawful for a person: (1) to receive a salary from the State or any of its departments which is not due..." Independent reviews of pay calculations and independent verifications of pay rates, work hours, termination dates, leave balances, etc. increase the probability that errors will be detected and corrected in a timely manner and that payroll checks will be processed for the proper amounts.

We continue to recommend that the School adhere to all State laws and regulations including those covering employee pay. The accounting department should develop and implement procedures to ensure that the partial pay calculation methods for twelve-month and less-than-twelve-month employees, as applicable, are consistently used to calculate each type of nonroutine pay including partial periods and termination pay. In addition, procedures should be implemented to ensure that payroll calculations are independently checked for mathematical accuracy and information in those computations is independently verified with supporting documentation.

MANAGEMENT CONTROL OVER FINANCIAL OPERATIONS

During our testwork, we noted that the School did not have sufficient funds to pay for fiscal year (FY) 1998 operating expenditures. In approximately April 1998, the School realized that an operating deficit would occur prior to the close of the fiscal year. In response, the School's management asked for and received additional Medicaid funds from the South Carolina Department of Health and Human Services. However, at year-end the School was still not able to pay all invoices for FY 1998. The School also held indirect cost recoveries not already remitted to the State's General Fund. Because the additional funds were obtained, the situation was not discussed with the entire board and they were not notified of the shortage at year-end. The Budget and Control Board was notified but offered no additional financial assistance.

As a result of the School's actions, FY 1998 obligations totaling \$300,000 were paid with FY 1999 funds and \$119,000 in indirect cost recoveries for fiscal year 1998 Medicaid reimbursements were not remitted to the State General Fund. These conditions are in violation of several state laws and regulations. Section 11-35-45 of the South Carolina Code

of Laws states, "All vouchers for payment of purchases of goods or services shall be delivered to the Comptroller General's office within thirty work days from acceptance of the goods or services and proper invoice." Also, Section 2 of the 1998 Appropriation Act states, "Subject to the terms and conditions of this act, the sums of money set forth in this Part ... are appropriated ... to meet the ordinary expenses of the state government for Fiscal Year 1997-98, and for other purposes specifically designated." Further Section 2-65-70 of the South Carolina Code of Laws states, "All indirect cost recoveries must be credited to the general fund of the State ..."

In our opinion, the operating deficit is a result of the School's failure to record budgetary information in its new accounting system. Without this information, management is precluded from properly monitoring available resources. [See General Ledger comment.]

We recommend that the School properly record and maintain budgetary information in its accounting system and that this information be made available to personnel responsible for spending decisions. Further, the School should keep its Board informed of its ongoing financial condition and seek outside assistance and guidance when necessary. Finally, the School should remit the indirect cost recoveries of \$119,000 to the State General Fund.

OPERATING LEASE CLOSING PACKAGE

The State Comptroller General obtains certain generally accepted accounting principles (GAAP) information for the State's financial statements from agency-prepared closing packages. We determined the School submitted to the Office of the Comptroller General an incorrectly prepared and misstated operating lease closing package. [The State Auditor's Reports on the School for fiscal years 1995 and 1997 also included findings of errors on the operating lease closing package. We applied no procedures to the School's accounting records and internal controls for the year ended June 30, 1996.]

The School's operating lease closing package had several errors and omissions. Section 3.19 of the Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) explains that the State Treasurer requires agencies to complete a lease register at the beginning of the lease, which will ensure that each is properly classified as a capital or an operating lease. We determined that the final payment date reported on two lease registers and the lease payment amounts reported on three lease registers differed from the information in the applicable lease agreements. Also, a lease with a remaining term of less than one year was reported but should not have been. Finally, only six of the twelve copier leases were included in the closing package.

In order to accurately report the School's financial information and proper disclosures, the GAAP closing packages must be complete and accurate. Furthermore, Section 1.8 of the GAAP Manual states that the agency head and finance director are responsible for submitting closing packages that are “•Accurate and completed in accordance with instructions. •Complete. •Timely. . . “

We again recommend the School implement procedures to ensure that the operating lease closing package and the supporting documentation contain accurate and complete information in accordance with the GAAP Manual requirements and instructions. The School should have in place procedures to account for all lease agreements and to identify, accumulate, and summarize the closing package information. Finally, the School should ensure that personnel preparing and reviewing the closing packages are knowledgeable about GAAP and familiar with the GAAP Manual guidance related to specific closing packages for which they are responsible. Each completed form and the underlying working papers and other support should be independently reviewed by an appropriate supervisory employee other than the preparer.

GENERAL LEDGER

The School's general ledger did not properly account for all fiscal year 1998 transactions. School officials informed us that the School had numerous problems with a new accounting system that was implemented during that year. We found that the School did not record appropriation and operating transfers. Accounting personnel told us that the budget was not loaded into the new system, so there was no reason to post adjustments to it. We were also unable to account for the numerical sequence of receipts and to trace receipt postings to the general ledger for fiscal months 01 through 07. When the accounting system was purchased it did not have an accounts receivables/receipts system. The system had to be written for the School and was not placed into operation until fiscal month 08. Finally, we requested during the prior year's engagement that the School place its composite bank account (the School refers to it as the non-appropriated account) within its general ledger system. As of the end of fieldwork for our fiscal year 1998 engagement, the School had not complied with our recommendation.

Good business practices and strong internal controls require the proper maintenance of a general ledger system that provides complete, accurate and timely information necessary for making financial decisions [e.g., available resource information needed for spending decisions (see Management Control over Financial Operations comment)]. Further, generally accepted accounting principles (GAAP) require transactions to be properly recorded for financial statement presentation.

We recommend that the School utilize the internal control benefits provided by a common accounting system for all transactions including its composite bank account transactions. All transactions, including budget adjustments should be posted to the system.

RECONCILIATIONS

In May 1999, during our current engagement at the School, we requested monthly reconciliations for fiscal year 1998. Accounting personnel informed us that only a year-end reconciliation of expenditures was completed because the School had numerous recording problems with its new accounting software [see General Ledger comment]. A similar finding was noted in our prior report.

Section 2.1.7.20 of the Comptroller General's Policies and Procedures Manual (STARS Manual) explains that the only way certain errors in the agency's accounting and/or in the State's accounting system (STARS) can be detected is for "agency accounting personnel to perform regular monthly reconciliations." The guidance also states that such reconciliations must be performed at least monthly on a timely basis (i.e. shortly after month-end).

Preparing reconciliations in a timely manner will increase the probability of timely detection and correction of errors. We recommend, again, that the accounting department develop and implement procedures to ensure that reconciliations are performed timely and in the manner as required.

SECTION B – STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountant's Comments section of the State Auditor's Report on the School for the fiscal year ended June 30, 1997, and dated April 27, 1998. We determined that the School has taken adequate corrective action on the GAAP Closing Packages finding except for the subsection Operating Lease Closing Package which we have repeated in Section A. The School has not taken adequate corrective action on the Payroll and Reconciliations findings which we also have repeated in Section A.

MANAGEMENT'S RESPONSE

August 25, 1999

Thomas L. Wagner, Jr., CPA
State Auditor
1401 Main St., Suite 1200
Columbia, South Carolina 29201

Dear Mr. Wagner,

We have reviewed the draft report resulting from your application of agreed upon procedures to the accounting records of the South Carolina School for the Deaf and the Blind for the Fiscal Year ended June 30, 1998. We concur in your findings. Our response to your findings and recommendations follow:

Payroll

The accounting staff has been instructed to utilize the formula based on a percentage of the number of working days in a pay period for twelve month employees. This method was recommended by the Comptroller Generals Office in a memorandum dated June 13, 1985.

The situation regarding nine month employees is more complex. We will develop a standard method for this computation which will then be applied consistently.

Management Control Over Financial Operations

During Fiscal Year 1998 the School's IBM System 36 Mainframe Computer failed. This necessitated the purchase of a new computer and new accounting software. The conversion to a new system during a fiscal year, on an emergency basis, had a tremendous impact on the workload of the accounting staff. As a result, proper controls and reporting suffered.

Currently, the entire accounting system is under review. The purpose of this review is to assure the new system has the proper controls and that it is providing adequate financial information to management and the Board of Commissioners.

Operating Lease Closing Package

We realize the importance of submitting accurate closing packages to the Comptroller General. Procedures will be implemented to assure accuracy of future packages.

General Ledger

As stated in the Management Control Over Financial Operations section, the accounting system is currently under review. As part of this review, we will assure that all accounts are properly recorded in the General Ledger.

Reconciliations

As noted in your report, the lack of monthly reconciliations was due to problems related to the installation of the new accounting software. In the future, reconciliations will be performed in a timely manner.

I would like to express my appreciation to you and your staff for the advice and assistance provided.

Yours very truly,

Sheila S. Breitweiser, Ed.D.
President

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